

Halftime Adjustments

BWE 2026 Mid-Year Review

July 14, 2026





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Mid-Year Review for 2026

Entering 2026, the Federal Reserve continued to carefully balance risks toward its dual mandate objectives of maximum employment and price stability, as collective market conditions pointed to a measured sense of optimism. In January, the Unemployment Rate stood at 4.3%. Although above its post-pandemic lows, the rate remained well below historical norms, suggesting a labor market that was sluggish but stable.

The sluggishness stemmed from lower Nonfarm Payroll growth, averaging only +/-10,000 through calendar year 2025. The weaker prior-year results weighed on market sentiment, raising concerns about potential labor market deterioration in 2026, particularly amid lingering trade policy effects and the continued adoption of potentially job-disruptive Artificial Intelligence (AI) technology. This concern provided the impetus for Federal Funds rate cut expectations in 2026, as expressed by both market participants and Fed policymakers at the time.

Inflation metrics continued to remain elevated against the Fed's target levels, at least partly due to the effects of higher tariffs. Although uncertain, Fed policymakers viewed tariffs as likely to create a one-time pass-through effect on inflation.

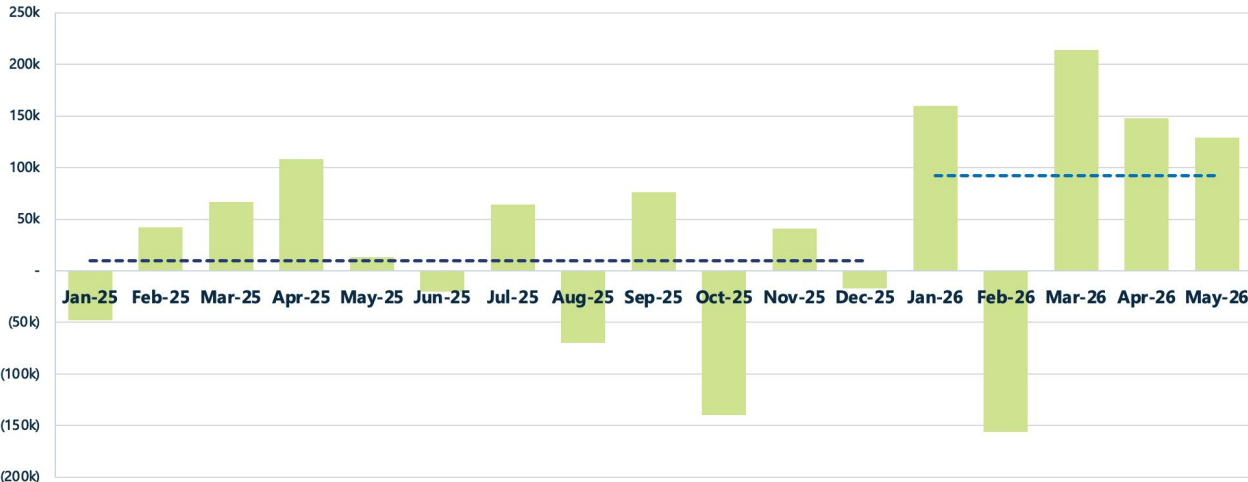
This theory postulated that wide-reaching tariffs imposed during 2025 would cause a short-term shock that would eventually normalize, underscoring beliefs of continued gradual progress toward the Fed's 2% inflation target.

As the concerns around the tariff passthrough appeared to dissipate, the unanticipated U.S.-Iran conflict injected a new source of inflationary concern – higher energy prices. This pushed the Fed into a more cautious stance. By the end of the first quarter, markets quickly repriced the monetary policy outlook, shifting from expectations for one or two Fed rate cuts this year, to a flat Federal Funds rate path. Although the forward outlook continues to evolve, the assumption that policy rates will remain unchanged through year-end is now facing renewed scrutiny as markets assess the latest FOMC meeting results. Under new Fed Chair Kevin Warsh, the latest Summary of Economic Projections (SEP) showed the median policymaker favoring a bias toward hikes in the second half of the year. The shift in monetary policy expectations pushed Treasury yields meaningfully higher compared with the start of the year, with the 10-year note averaging near 4.40% for the second quarter.

Labor Market Regains Its Footing

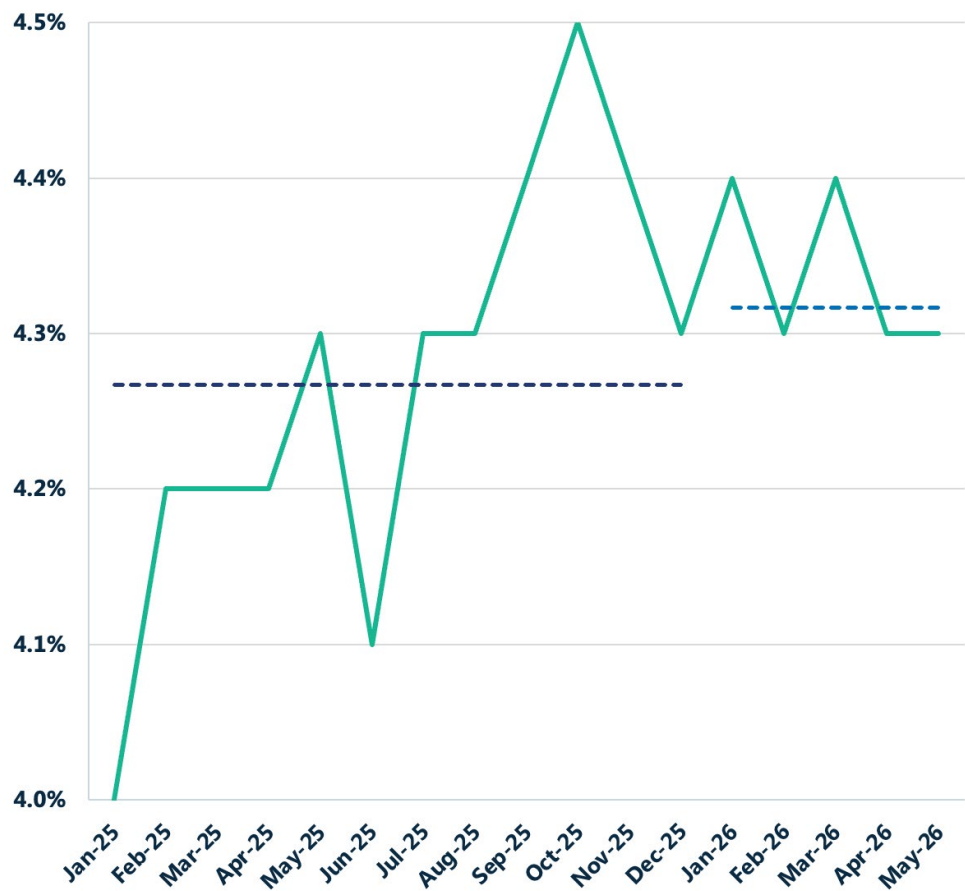
The outlook for labor in the U.S. continues to shift, as a variety of employment data increasingly indicates that job growth has accelerated after a turbulent 2025. Nonfarm Payrolls’ monthly data exceeded consensus estimates for most of the first half of the year. Year-to-date, Nonfarm Payrolls have averaged +92,000 in 2026, solidifying a recovering labor market foundation that saw cracks in the prior year. Amid the resilient Nonfarm Payrolls figures, unemployment has shown little movement since July 2025, averaging 4.3% through the period. As data continues to quell labor market concerns, attention has decisively shifted back to the inflation side of the Federal Reserve’s dual mandate.

Nonfarm Payrolls | Jan 2025 – Jun 2026
2025 Avg: 10k | 2026 YTD Avg: 92K



Source: Bloomberg, Bureau of Labor Statistics

Unemployment Rate | Jan 2025 – Jun 2026
2025 Avg: 4.27% | 2026 YTD Avg: 4.32%



Source: Bloomberg, Bureau of Labor Statistics

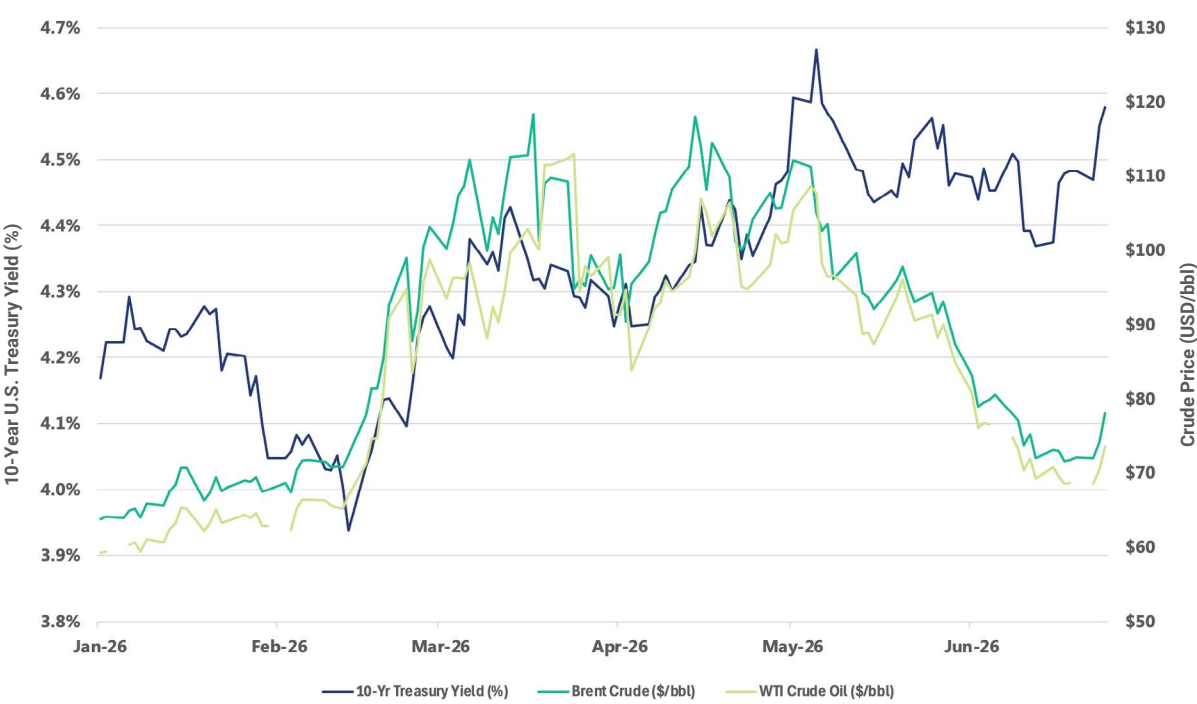
Iran Conflict Reshapes the Outlook

Outlooks for monetary policy were upended shortly after the outbreak of the U.S.-Iran conflict in late February. The U.S. commenced military operations through Operation Epic Fury, a series of strikes aimed at degrading Iranian military capabilities, while simultaneous Israeli strikes targeted Iranian leadership, leading to the assassination of Supreme Leader Ali Khamenei. Iran responded through missile and drone attacks on Israel, U.S. military bases in the region, and U.S.-allied Gulf States. The Iranian military effectively closed the Strait of Hormuz, a vital waterway carrying roughly 25% of global seaborne oil trade and 20% of Liquefied Natural Gas (LNG) shipments, reducing vessel traffic to single-digit levels within days of the conflict’s escalation.

The energy price shocks were immediate and severe. Closing levels on front-month Brent crude oil futures surged from approximately \$72/barrel on February 27 to a peak of \$118/barrel on March 31, a gain of roughly 63% in just over a month. This injected fresh uncertainty into the inflation and growth outlook and drove a sharp repricing of Treasury yields. While a delicate ceasefire took hold around April 8, sending oil prices sharply lower, the truce has proven fragile. Iran fired missiles at the UAE in early May; Strait of Hormuz clashes strained the ceasefire again in mid-May; and in early June, President Donald Trump signed an interim peace agreement with Iran that aims to normalize traffic through this crucial waterway. However, this agreement collapsed in early July as Iran struck commercial vessels flowing through the Strait of Hormuz. The U.S. responded by launching strikes against Iran and reinstating sanctions on Iranian oil sales, leaving markets once again questioning the durability of recent frameworks, including the recently signed Memorandum of Understanding.

These events leave the pace and extent of normalization to the Strait of Hormuz uncertain. In early July, Brent crude oil futures traded near \$80/barrel, still above pre-conflict levels but well off its peak, leaving an ambiguous energy risk factor to trickle into inflation expectations and long-end rates.

Brent and WTI Crude Oil vs 10-Yr Treasury Yield | 2026 YTD



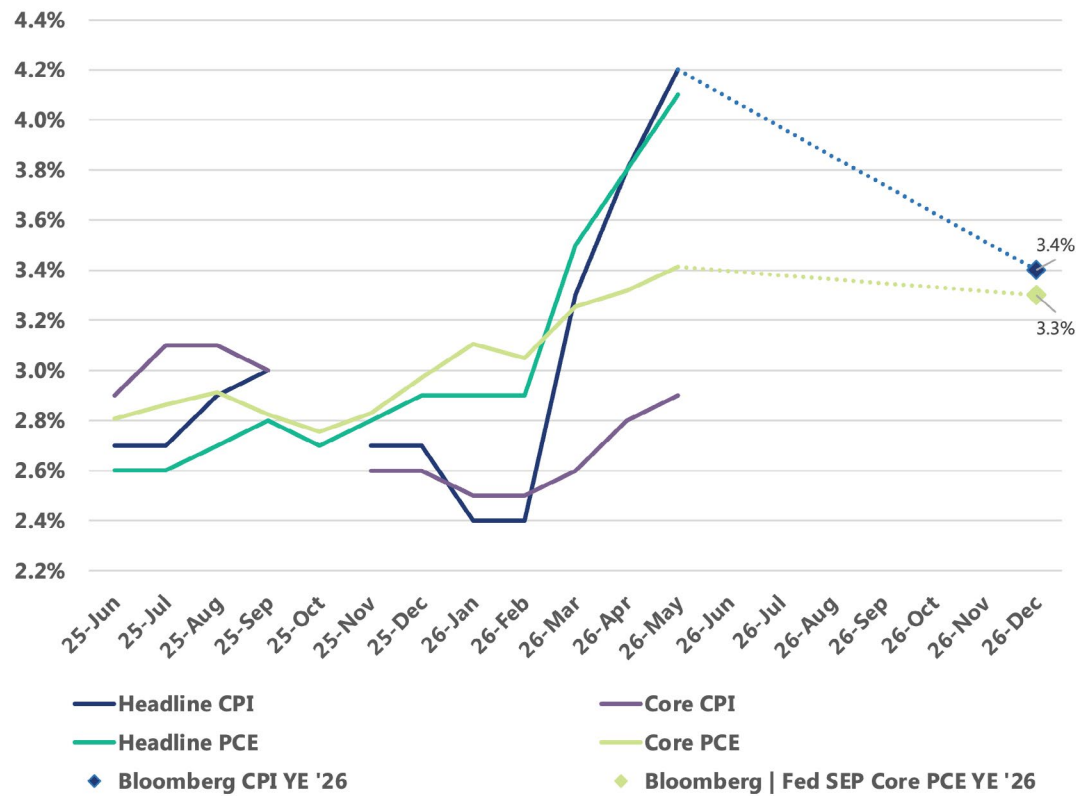
Source: Bloomberg

Energy Intensifies the Inflation Fight

The Iran conflict’s energy shock materially complicated what had been a constructive inflation trajectory entering the year. After gradually moving toward the Fed’s target in January, headline Consumer Price Index (CPI) rose sharply through the spring as higher energy costs flowed into consumer prices, reaching the high-3% range by April. Core CPI, which strips out food and energy and better reflects underlying demand, has been more contained but has also drifted higher. The Fed’s preferred inflation gauge, annual Personal Consumption Expenditures (PCE), tells the same story: both headline and core PCE readings moved up over the period and continue to sit meaningfully above the 2% target, causing unease among Fed policymakers. The clear direction is one of renewed upward pressure, driven primarily by energy, after months of gradual improvement.

The critical question for the second half of 2026 is whether the energy-driven spike in headline inflation proves temporary, consistent with the Fed’s original tariff pass-through thesis, or whether it broadens into services and shelter in a way that forces a more durable policy response.

**Inflation: CPI vs PCE (YoY %) | Actuals to May 2026
Forecasts (Bloomberg, Fed SEP) to YE 2026**



Source: Bloomberg, Federal Reserve, Bureau of Labor Statistics

A New Era at the Federal Reserve

The story of the first half of 2026 is one of a dramatic and rapid reversal in the expected path of monetary policy. Entering the year, markets and Fed policymakers alike anticipated one-to-two Federal Funds rate cuts in 2026. That consensus unraveled as the Iran conflict escalated. At the April FOMC meeting, three Fed voting members dissented from the post-meeting statement's implied easing bias language, a rare and pointed signal that the Committee was beginning to be less tolerant of inflation risks and hinting that a shift in the direction of monetary policy was plausible. Markets responded swiftly, repricing the rate path from rate cuts to flat/neutral, and then further toward the expectation of Federal Funds rate hikes.

Kevin Warsh assumed the leadership role of Federal Reserve Chairman in May 2026. At its June meeting, the FOMC held the Federal Funds rate unchanged at 3.50% to 3.75%, a fourth consecutive hold. Warsh's overriding message was a decidedly hawkish shift squarely focused on crushing inflation, signaling that the Fed's next move would more likely be an interest rate hike than a rate cut. The accompanying statement was notably shorter and dropped the forward guidance on the timing of additional adjustments, leaving the next move ambiguous for timing. The Committee attributed inflation to broad-based supply-side pressures across multiple sectors rather than energy alone. Job gains were depicted as keeping pace with the labor force, with unemployment being little changed. In the terse Fed statement, the Committee unanimously flagged strong productivity, robust investment, and solid economic growth despite elevated uncertainty. The FOMC delivered a stern commitment to conclude the first Fed statement under Chairman Kevin Warsh: "The Committee will deliver price stability."

In the accompanying Summary of Economic Projections, policymakers voted with a hawkish tilt. The median year-end Federal Funds rate projection rose to 3.8%, with higher medians than were

previously projected extending through 2027 and 2028. Inflation projections were revised higher while GDP and unemployment were revised down, providing a stagflationary cast on the median assessment of economic conditions. Nine dot-plot participants now project one or more hikes by year-end, up from zero previously.

In his inaugural press conference, Warsh was staunch on achieving price stability. He called inflation a burden on Americans and confirmed the unanimous Fed resolve to return to its 2% target. However, he offered no guidance on the rate policy path and declined to submit his own dot-plot projection. He also announced several task forces that will review key areas for improving monetary policy: Fed communications; the Fed's balance sheet; the use and reliance on existing data sources; productivity and jobs; and the Fed's inflation framework. The task forces are expected to begin research over the coming weeks and produce results between the fall and year-end.

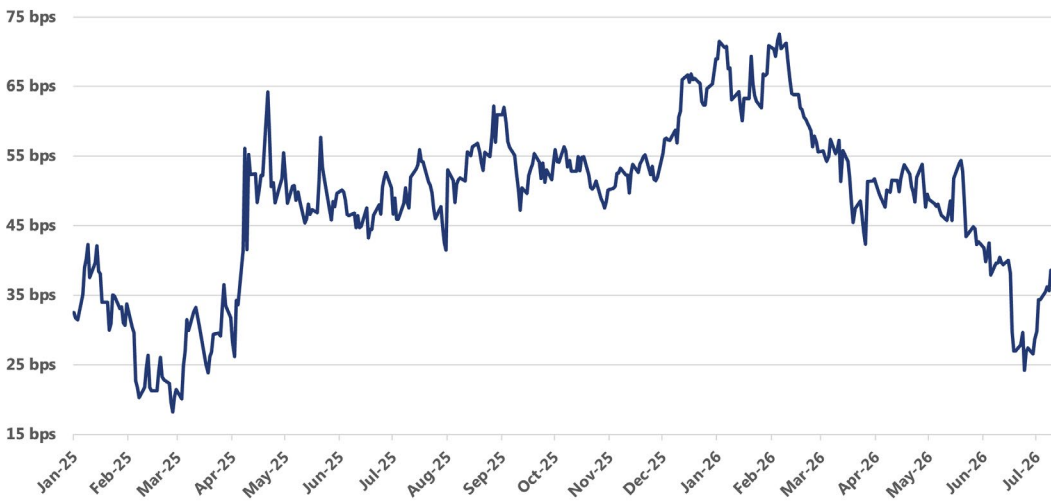
As of early July, Federal Funds futures imply a rate path that peaks near 4.07% around the March-April 2027 meetings, representing roughly 1.7-1.8 cumulative hikes from the current effective rate of approximately 3.63%, before reversing in the second half of 2027.

Taken together, the removal of forward guidance; the hawkish shift in the dot plot, with nine of 18 participants penciling in at least one hike for 2026; and Warsh's firm stance on price stability mark a meaningful tonal shift for the Fed under new leadership.

Reading the Field on Volatility

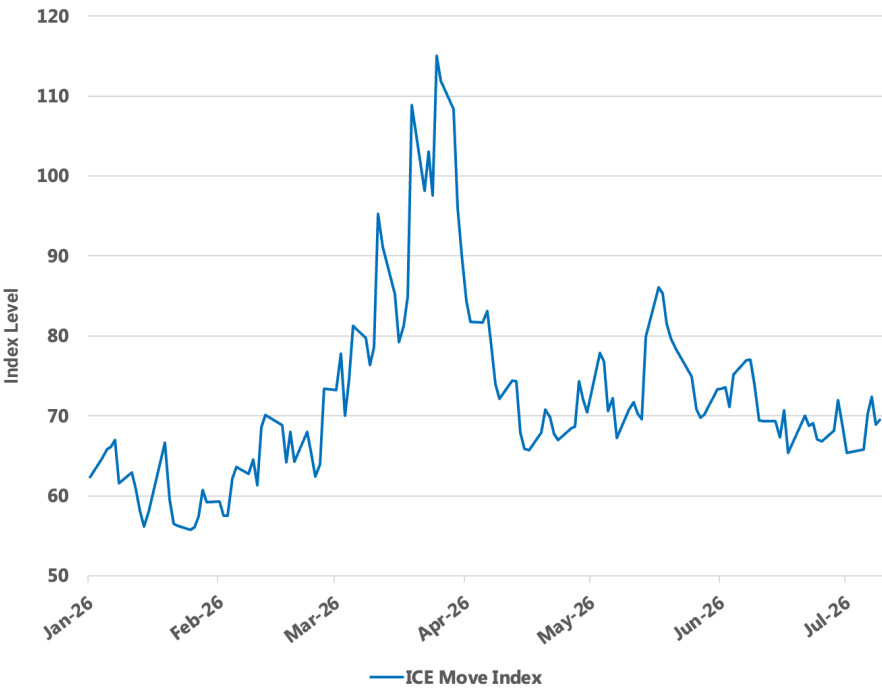
The benchmark 10-year U.S. Treasury note began the year opening at 4.17% and briefly rallied to a closing year-to-date low of 3.94% on February 27 as U.S. economic growth fears momentarily dominated. The yield then reversed sharply as the Iran conflict escalated, reaching a closing peak of 4.67% on May 19. The intra-period range of nearly 75 basis points from trough to peak in the benchmark’s yield underscores the execution risk (volatility) embedded in rate lock timing through the first half. At this junction, bond markets are poised for increased volatility considering the ambiguity surrounding Fed communications. Warsh’s decision not to participate in the latest SEP, coupled with the brevity of Fed statements and hints of communication reform, positions bond markets with a lesser degree of monetary policy guidance moving forward. By issuing less guidance, markets are forced to develop an independent assessment of risks to the Fed’s dual mandate objectives, keeping in mind that monetary policymakers are unanimous in their commitment to delivering stability.

2- to 10-Yr Treasury Curve (2025 - Present)



Source: Bloomberg

ICE MOVE Index – 2026 YTD



Source: Bloomberg, ICE Data

During the first half of 2026, the U.S. 2-year and 10-year Treasury yield curve remained upward sloping at approximately 71 basis points but flattened over the course of the first half as market expectations for Federal Reserve policy shifted. By the second quarter’s end, the curve had dramatically flattened to roughly 27 basis points. Sticky inflation, including headline PCE nearing 4.1%, and hawkish signals from incoming Fed officials led markets to abandon expectations for Federal Funds rate cuts and prepare for possible rate hikes. Yields reached their 2026 highs from late May to mid-June, with the 2-year rising to 4.23%. By late June, a more benign inflation report provided modest relief.



Agency CMBS

Steady Under Pressure

Agency CMBS entered 2026 carrying significant momentum from 2025. Spreads hovered at multiyear tights, supported by a persistent supply/demand imbalance that tilted executions in the borrowers' favor. Institutional investor demand remained well supported by favorable regulatory capital treatment, while Agency CMBS's embedded prepayment protections and attractive convexity characteristics continued to draw steady buyer interest. Spreads sit at or near year-to-date tights as we head into the second half of the year. Recently, lighter new-issuance rate-lock volumes have been supported by an active buyer base, with institutional investor demand remaining firm.

The 2026 YTD narrative has been shaped by three overlapping forces:

- Policy-driven spread tightening in January triggered by President Trump's \$200 billion MBS purchase directive to Fannie Mae and Freddie Mac
- Favorable comparisons against corporate credit spreads and residential mortgage-backed securities amid geopolitical volatility
- Constructive supply/demand dynamics in Agency CMBS new issuance

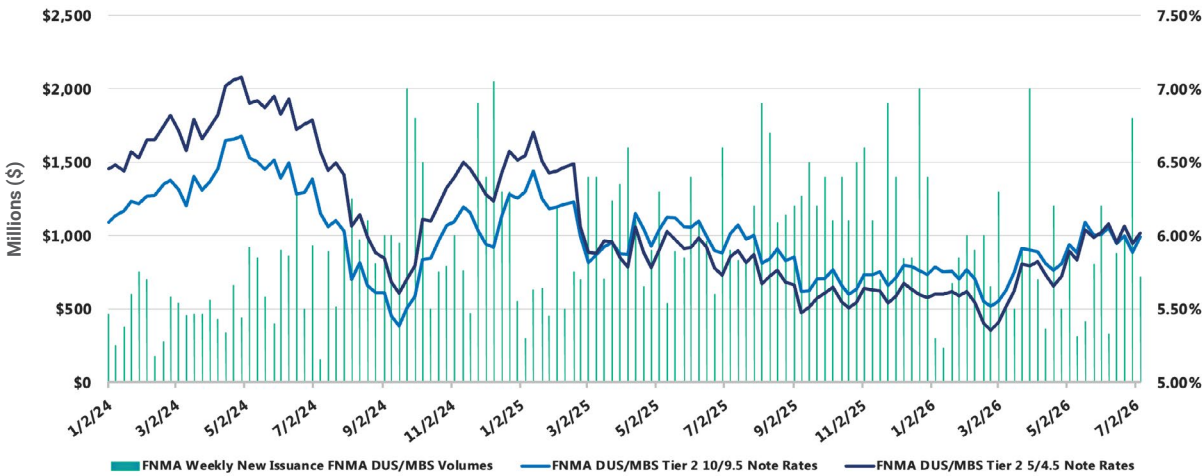
Spreads Hold Their Ground

Credit spreads narrowed moderately across most commercial real estate sectors in the first half of 2026 despite a challenging and noisy macroeconomic environment. At the start of the year, President Trump directed Fannie Mae and Freddie Mac to purchase \$200 billion in MBS to increase demand for mortgage bonds, lower mortgage rates, and improve homeownership affordability. Though this mandate primarily targeted residential MBS, Agency CMBS credit spreads also benefited. This shot in the arm in demand for Agency MBS and CMBS, coupled with the FHFA’s 2026 charge for each multifamily GSE to increase its loan purchase cap to \$88 billion individually (a 20.5% increase over 2025 goals), helped drive overall investor/credit spreads to lows last seen in the fall of 2021. As has been the case for over a year, investor demand in the Agency CMBS sector remains strong for larger loans (\$20 million+), liquid core structures (5/4.5, 7/6.5, 10/9.5), full-term interest-only options, and transactions with interest-rate buydowns.

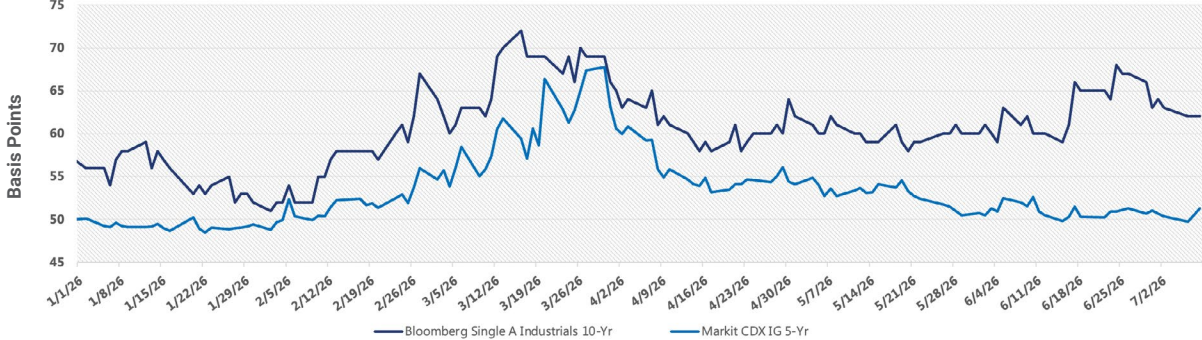
Through the onset of the U.S.-Iran conflict, the credit spread environment for Agency CMBS has held remarkably firm. This is partly due to slower second-quarter Agency CMBS rate lock activity, which has supported favorable technical conditions as a strong buyer base keeps spreads narrow. In addition to technical factors, Agency CMBS spreads demonstrated notable resilience while broader investment-grade fixed-income products faced persistent headwinds from the conflict in the Middle East and elevated geopolitical uncertainty. Simply stated, Agency CMBS is considered a “safe play” during market turbulence. Corporate credit spreads widened somewhat in the first half of 2026 due to a myriad of factors, including AI disruption risks, private credit concerns, and the Iran conflict, while Agency CMBS spreads remained near historical tights, highlighting the defensive characteristics of the asset class.

Several structural factors help explain the inertia in Agency CMBS spreads. The explicit GSE guarantee insulated Agency CMBS from credit risks that weighed on corporate issuers, while prepayment protections contribute to an attractive convexity and predictable cash flow profile.

FNMA Weekly New Issuance DUS/MBS Volumes and Note Rates



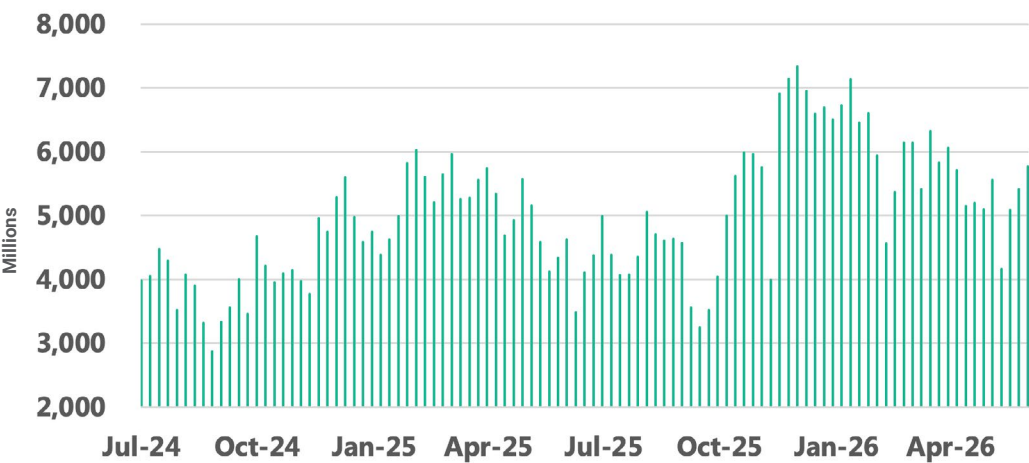
Corporate Credit Spreads (2026 - Present)



Strong supply-demand dynamics have consistently supported spread stability, as end-account demand has helped keep spreads firm even when broader market sentiment weakened. Taken together, these characteristics positioned Agency CMBS as a defensive, high-quality alternative within fixed income allocations, allowing credit spreads to hold firm even as geopolitical volatility drove wider dispersion across other sectors.

Deep Bench of Buyers

Primary Dealer Net Positions: Federal Agency and GSE CMBS



Source: Federal Reserve Bank of New York

Agency CMBS has established itself as a core, investment-grade fixed-income allocation for a diverse and growing institutional buyer base, driven by its unique combination of GSE-backed credit quality, structural convexity advantages, and favorable capital treatment. Insurance companies, especially life insurers with long-duration liabilities, have long been reliable buyers of Agency CMBS, attracted by its spread pickup over comparable Treasuries, high-quality risk profile, and favorable regulatory treatment that helps limit risk-based capital charges. Banks, consistent buyers of ACMBS paper, also maintain meaningful balance sheet investment allocations, benefiting from the zero risk-weight treatment afforded to Ginnie Mae-backed securities and favorable risk-based capital treatment for Fannie Mae and Freddie Mac ACMBS assets. Additionally, the Fed (along with OCC and FDIC) announced a more favorable Basel III “Endgame” proposal for commercial banks in mid-



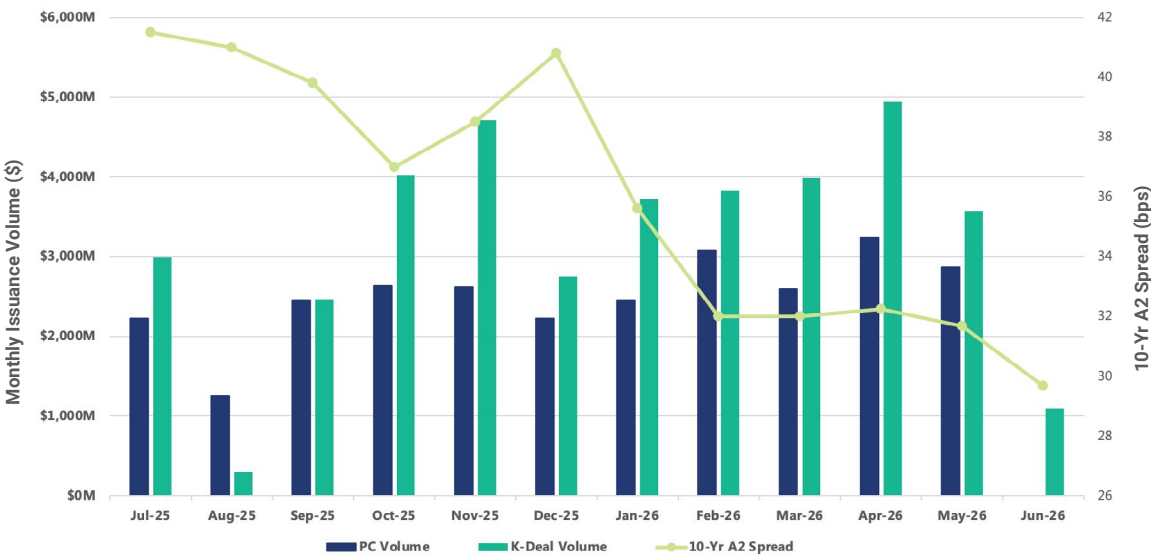
March. If adopted, the proposal could lower banks’ capital reserve requirements, increasing liquidity for lending and investment activity. Asset swap buyers and relative-value funds have supported demand when spread-to-swaps levels offer attractive carry compared with investment-grade corporates or Agency MBS pass-throughs. Features such as prepayment lockouts, defeasance provisions, and yield maintenance premiums give Agency CMBS more predictable cash flow profiles than residential MBS, reducing extension and contraction risk (i.e. duration) that often complicates liability-matching mandates.

It is also worth noting one important structural shift in the Agency buyer base. Beginning December 1, 2025, the Federal Reserve balance sheet began reinvesting its Agency CMBS principal payments into U.S. Treasury securities rather than additional Agency CMBS purchases. Said differently, the Fed is now gradually stepping back as an Agency CMBS buyer. Private institutional demand has had to absorb that exit, and the fact that spreads remain historically tight despite the Fed’s withdrawal suggests persistent underlying demand from the private sector. This is further evidenced by resilient and growing Agency CMBS allocations on dealer balance sheets.

Issuance Keeps Pace

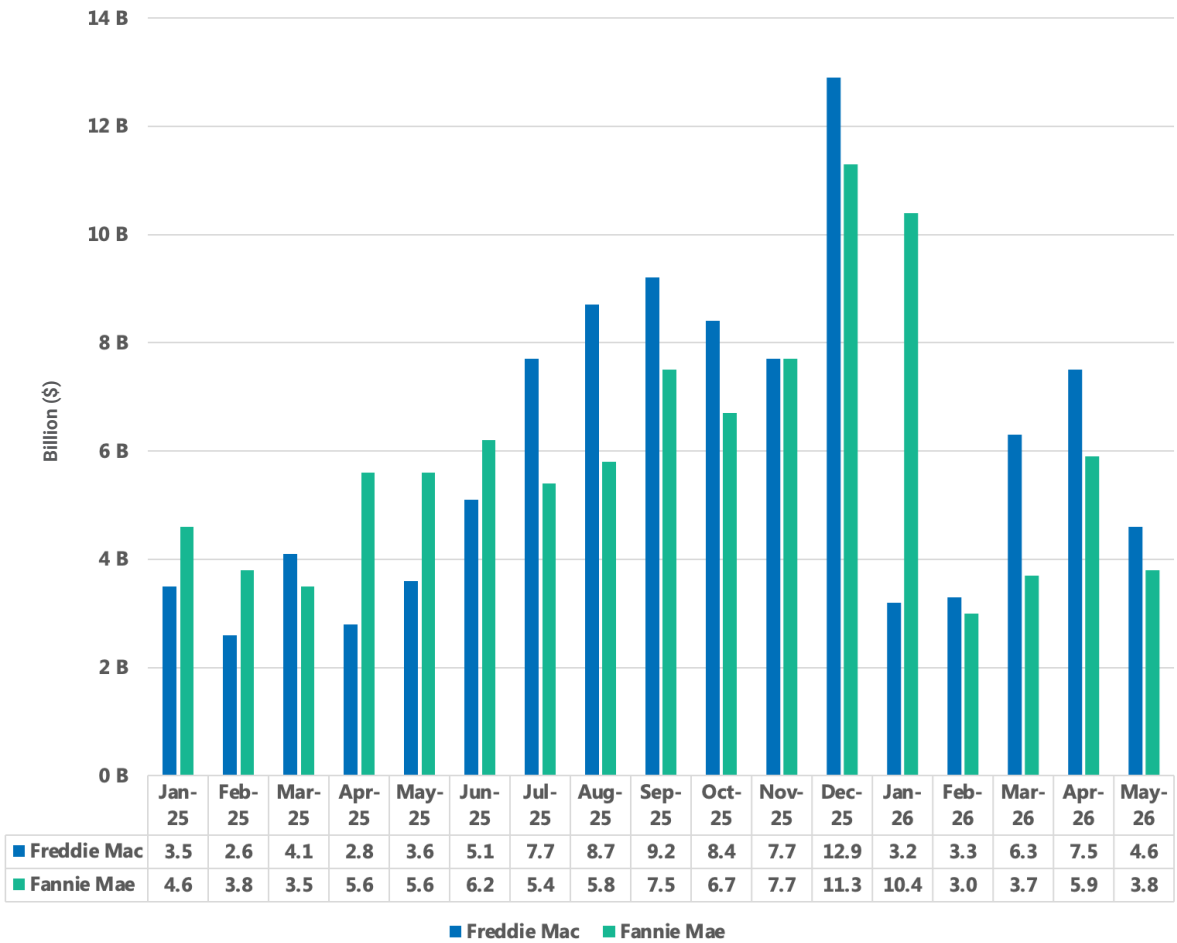
Overall, the supply of new issue Agency CMBS volumes is pacing ahead of last year’s figures YTD, though there is a widening bifurcation in pacing among the individual GSEs. Through May 2026, year-to-date volumes of Freddie Mac Multifamily New Business Activity rose to \$25.0 billion, a sharp 49.1% increase from the prior year. Meanwhile, Fannie Mae Multifamily Monthly Business Volumes rose more slowly with a 16.5% increase from last year with approximately \$26.8 billion through May. In late 2025, the Federal Housing Finance Agency (FHFA) set the 2026 GSE multifamily loan purchase caps at \$88 billion each for Fannie Mae and Freddie Mac, totaling \$176 billion in support of the multifamily market. Both Agencies have historically seen a strong pickup in volumes during the second half of the year.

Freddie Mac Multifamily Issuance & 10-Yr K-Deal A-2 Spread (Trailing 12 Months)



Source: Freddie Mac

Fannie Mae and Freddie Mac Multifamily Business Volumes (2025 - YTD)



Source: Fannie Mae and Freddie Mac



Looking Ahead: Navigating Uncertainty

The Treasury yield environment as of mid-year 2026 has been shaped by a constellation of forces whose resolution remains deeply uncertain. The signing of a U.S.-Iran Memorandum of Understanding has sent crude oil prices tumbling from their April peak as markets priced in a gradual reopening of the Strait of Hormuz. The dynamism of ongoing negotiations in the Middle East leaves energy markets, and by extension the inflation outlook, vulnerable to reversal.

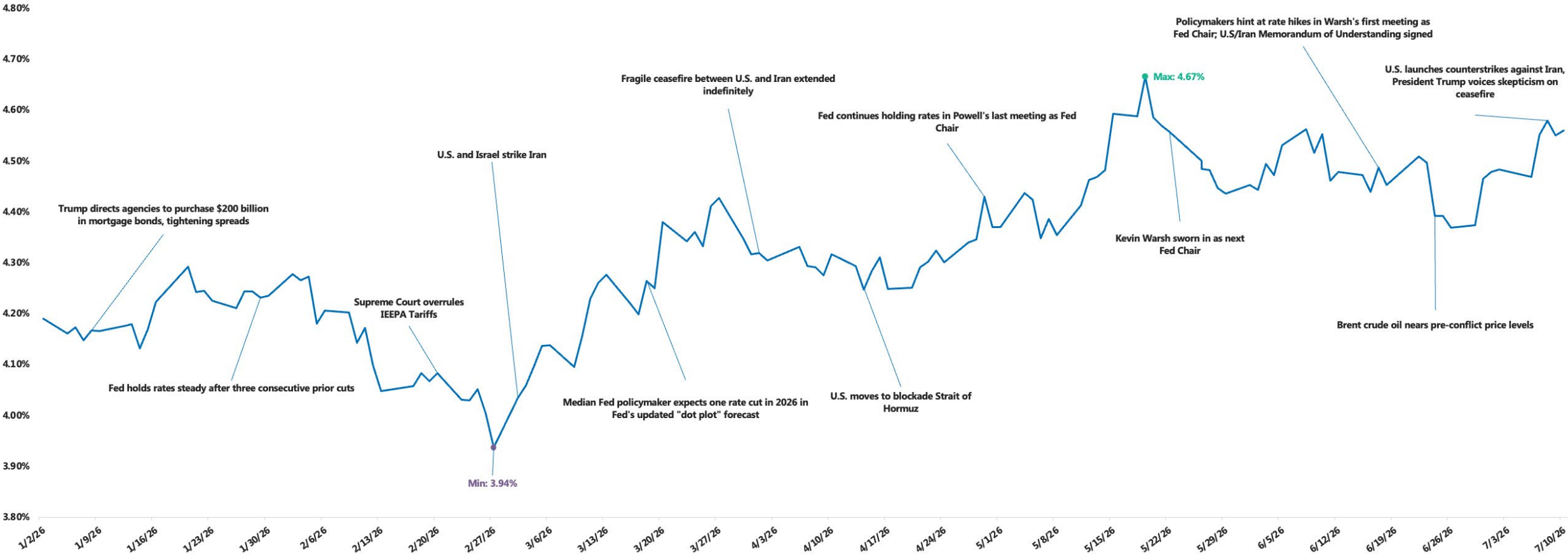
On the monetary policy front, markets are now (at the time of this writing) fully pricing in a rate hike by the October FOMC meeting. This sharp repricing in monetary policy expectations has flattened the yield curve and pressured shorter-dated Treasuries, even as Warsh's broader reform agenda, including five newly constituted task forces, introduces an additional layer of regime uncertainty into already unsettled rate markets. For Agency CMBS specifically, the Freddie Mac and Fannie Mae execution channels have offered a relatively safe harbor: spreads remain historically attractive, and Agency issuance has remained active, though the combination of an upwardly revised rate path and a still-unresolved energy price shocks leaves the market prone to bouts of

volatility. Borrowers and capital markets participants alike will need to navigate a second half of 2026 in which the pace of Strait of Hormuz normalization, the credibility of the Fed's commitment to deliver price stability, and the durability of relative value perceptions in Agency CMBS each carry outsized consequences for where credit spreads and all-in borrowing costs ultimately settle.

Key Points of Focus for Second Half of the Year:

- Iranian Conflict – Reopening/Normalization of Strait of Hormuz
- Fed Chair Warsh Era/Reshaping of the Fed
- AI Economic Implications
- Mid-Term Elections
- New Issue Corporate and Agency CMBS Supply

10-Year U.S. Treasury Yield Closing Rates



Source: Bloomberg, BWE

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Jim Drizos

EVP, Senior Managing Director
of Capital Markets



Mitch Ross

SVP, Director of
ACMBS Trading



Jared Rodgers, CFA

Capital Markets
Associate Trader



Philip Njapa

Capital Markets
Analyst



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